

**UNITED STATES DISTRICT COURT
DISTRICT OF NEW HAMPSHIRE**

UNITED STATES OF AMERICA

v.

**ROBERT J. GAGALIS,
BRUCE D. KAY, and
GAYLE SPENCE a/k/a GAYLE S. LUACAW,**

Defendants.

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: **Criminal No.:** _____
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INDICTMENT

The Grand Jury charges:

**COUNT ONE
Conspiracy to Commit Wire and Securities Fraud
18 U.S.C. § 371**

A. Background

At all times relevant to this Indictment:

The Company

1. Enterasys Network Systems, Inc., (“Enterasys”) was a Delaware corporation headquartered in Rochester, New Hampshire. The primary business of Enterasys and its affiliated companies was designing and selling hardware and software systems for computer networks and providing related support services.

2. Enterasys was a publicly traded company and its stock was traded under the symbol “ETS” on the New York Stock Exchange, a national securities exchange. Enterasys succeeded Cabletron Systems, Inc. (“Cabletron”) when the two companies merged on August 6,

2001. The owners of Enterasys' stock resided throughout the United States, including in the District of New Hampshire.

The Defendants

3. Defendant ROBERT J. GAGALIS ("GAGALIS"), a Certified Public Accountant, was an Executive Vice President and the Chief Financial Officer at Enterasys. Defendant GAGALIS was employed by Enterasys and Cabletron from on or about June 26, 2001, to on or about November 15, 2002.

4. Defendant BRUCE D. KAY ("KAY"), a Certified Public Accountant, was the Senior Vice President of Finance at Enterasys. Defendant Kay was employed by Enterasys and Cabletron from on or about February 18, 1999, to on or about April 30, 2002.

5. Defendant GAYLE SPENCE, a/k/a GAYLE S. LUACAW ("SPENCE") was a Vice President and the Director of Internal Sales at Enterasys and served in the Office of the Executive with Enterasys' Chairman, President and Chief Executive Officer. Defendant SPENCE was employed by Enterasys and Cabletron from on or about October 5, 1992, to on or about April 9, 2002.

The Federal Securities Laws and Regulations

6. As a publicly traded company, Enterasys and its directors, officers and employees were required to comply with the federal securities laws and regulations. Those laws and regulations were designed to ensure that the financial information of publicly traded companies is accurately recorded and disclosed to the investing public.

7. Under the federal securities laws and regulations, Enterasys was required, among other things: (a) to make and keep books, records, and accounts that accurately and fairly

reflected the company's business transactions; (b) to devise and maintain a system of internal accounting controls that provided reasonable assurances that the company's financial transactions were recorded in a manner that would permit the preparation of financial statements in conformity with Generally Accepted Accounting Principles ("GAAP"); and (c) to file with the Securities and Exchange Commission ("SEC") quarterly reports (known as SEC Forms 10-Q), and other periodic reports that included accurate and reliable financial statements prepared in accordance with GAAP. In addition, Enterasys developed, and purported to follow, its own written revenue recognition policy that mirrored the requirements of GAAP in all pertinent respects.

8. As a publicly traded company, Enterasys also was required to retain outside auditors to review, audit and test its financial statements for compliance with appropriate accounting rules. During quarterly reviews and annual audits, Enterasys' outside auditors routinely tested whether Enterasys properly recognized the revenue it booked from selected transactions. The auditors' testwork included confirming, for each selected revenue transaction, that there was evidence of an arrangement during the period under review, that there were no rights of return or exchange or other contingencies, that the sales price was fixed and determinable and that Enterasys was reasonably assured of being able to collect the sales price from the customer.

Relevant Enterasys Customer

9. Ariel International Technology Company, Ltd. a/k/a Artel and Arcon ("Ariel") was a distributor of computer networking products in China.

B. The Conspiracy

10. From in or about July 2001 to in or about at least March 2002, defendants GAGALIS, KAY and SPENCE, together with others, known and unknown to the Grand Jury, conspired to, and did, devise and execute a scheme to defraud Enterasys shareholders, the SEC and others, and to deprive Enterasys of its right of honest services.

Purposes

11. Among the purposes of the conspiracy were: (a) to ensure that Enterasys would report that the company had met or exceeded internal revenue projections and the published expectations of Wall Street analysts, regardless of the company's actual financial results; (b) to artificially maintain and increase the market price of Enterasys stock; and (c) to maintain the conspirators' status and positions within the company.

Manner and Means

12. It was part of the conspiracy that defendants GAGALIS, KAY and SPENCE and others would and did cause Enterasys to fraudulently and improperly recognize revenue on its books and records.

13. It was further part of the conspiracy that, on or about August 31, 2001, one day before the close of Enterasys' fiscal quarter, a senior executive in Enterasys' Asia-Pacific ("APAC") sales division [hereinafter referred to as "Co-Conspirator A"] and others caused Enterasys to recognize revenue from a transaction with Ariel in which Enterasys retained primary responsibility for selling the products and in which Enterasys granted Ariel extended payment terms of up to 150 days.

14. It was further part of the conspiracy that, in response to a later inquiry from Enterasys' outside auditors concerning the Ariel transaction, defendants GAGALIS, KAY and SPENCE and others did, and caused others to:

- (a) falsify, alter and backdate documents to create the false impression that Enterasys and Ariel had completed a sales transaction on or about August 31, 2001, that qualified for revenue recognition in the quarter ended September 1; and
- (b) execute and provide to Ariel a secret side letter reinstating certain terms that had been excised from an original sales document and which would have precluded Enterasys from recognizing revenue during the quarter ended September 1.

15. It was further part of the conspiracy that defendants GAGALIS, KAY and SPENCE and others improperly recorded, and caused others to record improperly, approximately \$3.5 million in net revenue from the transaction with Ariel during the quarter ended September 1, 2001, even though they had caused Enterasys secretly to:

- (a) alter the evidence of the arrangement with Ariel after September 1;
- (b) retain primary responsibility for selling the product it had purportedly sold to Ariel; and
- (c) grant Ariel extended payment terms.

16. It was further part of the conspiracy that defendants GAGALIS, KAY and SPENCE and others caused Enterasys to recognize revenue during the quarter ended September 1, 2001, in violation of both GAAP and the company's internal revenue recognition policy in

that: (a) the true and full sales agreement with Ariel provided that Enterasys retained significant obligations for future performance relating to the resale of the product by Ariel; and (b) the purchase price was not fixed or determinable in view of extended payment terms granted to Ariel.

17. It was further part of the conspiracy that defendants GAGALIS, KAY and SPENCE and others provided, and caused others to provide, false and misleading information to Enterasys' outside auditors by, among other things: (a) giving the auditors altered and backdated documents; (b) withholding from the auditors important information, including the terms of the secret side letter with Ariel; and (c) making numerous affirmative misstatements of fact in a "Management Representation Letter" sent by Enterasys to its auditors on or about September 24, 2001.

18. It was further part of the conspiracy that defendants GAGALIS, KAY and SPENCE and others caused Enterasys to issue a press release and to make public statements about the company's financial performance based on fraudulently recorded revenue.

19. It was further part of the conspiracy that defendants GAGALIS, KAY and SPENCE and others caused Enterasys to prepare, to file with the SEC and to disseminate to the investing public, an SEC Form 10-Q that reported financial results for the quarter ended September 1, 2001, that included fraudulently recorded revenue.

C. The Product Enterasys "Sold" to Ariel Is Sold Elsewhere

20. On or about December 19, 2001, complaining that Enterasys had not found purchasers for the product purportedly sold to Ariel, Ariel cancelled its purchase order with Enterasys. In or about December 2001, Enterasys purportedly sold the product to a third party

and made arrangements for the freight forwarder that had been holding the product to deliver it to the third party.

D. Enterasys Restates Its Financial Results

21. In or about late January 2002, during the course of the company's annual audit, Enterasys' outside auditors became aware that there were at least two different versions of the Letter of Agreement with Ariel and so notified Enterasys' management.

22. After the close of the market on February 1, 2002, Enterasys publicly announced that it was investigating problems relating to a \$4 million APAC sales contract and other APAC sales activity, that the SEC had issued a formal order of investigation relating to the company and that the company was delaying the reporting of its fiscal year results.

23. The next trading day, Enterasys' stock price plummeted from \$10.80 per share to \$4.20 per share, or more than 60%. The stock price drop reduced the value of Enterasys stock held by the public by more than \$1.3 billion.

24. On or about November 26, 2002, Enterasys restated its previously reported financial results for its fiscal quarter ending September 1, 2001, and other periods. The restatement included the reversal of the \$3.5 million in net revenue previously recognized from the Ariel transaction.

E. The Conspiracy Charge

25. From in or about July 2001 to in or about at least March 2002, in the District of New Hampshire and elsewhere, the defendants,

**ROBERT J. GAGALIS,
BRUCE D. KAY, and
GAYLE SPENCE a/k/a GAYLE S. LUACAW,**

did knowingly and willfully combine, conspire, confederate, and agree with others, both known and unknown to the Grand Jury, to commit certain offenses against the United States, namely (a) employing a device, scheme and artifice to defraud in connection with the offer and sale, and the purchase and sale, of Enterasys securities using the means and instrumentalities of interstate commerce, in violation of Title 15, United States Code, Sections 78j(b) and 78ff and Title 17, Code of Federal Regulations, Section 240.10b-5; (b) making untrue, false and misleading statements of material fact in reports and documents required to be filed under the Securities Exchange Act of 1934 and the rules and regulations thereunder, in violation of Title 15, United States Code, Sections 78j(b) and 78ff; (c) falsifying books, records and accounts of Enterasys, in violation of Title 15, United States Code, Sections 78m(b)(2)(A), 78m(b)(5) and 78ff, and Title 17, Code of Federal Regulations, Section 240.13b2-1; (d) making and causing to be made materially false and misleading statements and omitting to state and causing others to omit to state material facts to Enterasys' outside auditors in connection with the preparation and filing of a document and report required to be filed with the SEC, in violation of Title 15, United States Code, Section 78ff and Title 17, Code of Federal Regulations, Section 240.13b2-2; and (e) wire fraud in violation of Title 18, United States Code, Sections 1343 and 1346.

Overt Acts

In furtherance of the conspiracy, and to achieve and to attempt to achieve the objects thereof, the following overt acts were committed in the District of New Hampshire and elsewhere:

26. On or about August 31, 2001, the day before the quarter closed, Co-Conspirator A, on behalf of Enterasys, entered into a Letter of Agreement with Ariel relating to a purported sale of approximately \$4 million of product to Ariel. The Letter of Agreement provided that Enterasys would retain primary responsibility for selling the product and that Ariel would have up to 150 days to pay for the product.

27. On or about August 31, 2001, Co-Conspirator A caused Enterasys to obtain from Ariel a purchase order, subject to the terms of the Letter of Agreement, for approximately \$4 million of product.

28. On or about August 31, 2001, Co-Conspirator A recorded and caused others to record approximately \$3.5 million in net revenue from the Ariel transaction on Enterasys' books and records for the quarter ending September 1.

29. On or about September 18, 2001, an employee in Enterasys' finance department [hereinafter referred to as "Co-Conspirator D"], after having been informed that Enterasys' outside auditors had requested the Letter of Agreement in connection with their review of selected revenue transactions, sent an email to defendants GAGALIS, KAY and SPENCE, Co-Conspirator A and others stating in part:

Bob, the one item that I have made no progress on is in obtaining the Letter of Agreement between Enterasys and Artel/Ariel. It is my understanding that Gayle has attempted to contact [Co-

Conspirator A] but has not received the appropriate document. I faxed the PO that referred to the agreement with [Co-Conspirator A] to Gayle, prior to the weekend. The reason that this is important is that we recognized \$3.9 million of revenue related to Artel/Ariel.

30. On or about September 18, 2001, an APAC employee emailed the original Letter of Agreement to defendant KAY and Co-Conspirator D and others.

31. On or about September 19, 2001, Co-Conspirator D forwarded the email from the APAC employee containing the original Letter of Agreement to defendants GAGALIS and KAY and another Enterasys employee, along with a message stating in part:

Bob, I received this email regarding the Artel/Ariel Agreement that [Enterasys' outside auditor] has requested. Bruce, [Enterasys' Controller] & myself called [APAC's Senior Director of Financial Operations] and discussed the Agreement. The wording in this Agreement places \$3.5M of revenue at high risk.

(Emphasis in original.) Co-Conspirator D's message further identified two terms in the Letter of Agreement that jeopardized Enterasys' ability to recognize revenue: (i) the provision making Enterasys primarily responsible for finding customers to purchase the product from Ariel; and (ii) the provision allowing Ariel up to 150 days to pay.

32. On or about September 19, 2001, Co-Conspirator D forwarded to Enterasys' Controller an email he had received from another Enterasys employee who had reviewed the original Letter of Agreement. The email from the other Enterasys employee to Co-Conspirator D stated:

Oh my head. Glad I knew nothing of this.

logistics, OK no sale
Responsible for selling is Enterasys, OK no sale
If we don't sell it they don't pay, OK no sale

Ultimate liability not for 150 days, OK no sale
Good Luck!

33. On or about September 19, 2001, defendant KAY, after receiving the original Letter of Agreement, sent an email to defendants GAGALIS and SPENCE, Co-Conspirator A and others, stating in part:

The language in this contract is going to give us major problems with our auditors. Two significant problems, the language screams out that we are responsible for selling the product (meaning we haven't really sold it yet) and payment terms that are tied to us selling the product out of channel. Also, 150 days is not acceptable.

We need changes, overnight, in the first language to eliminate the direct terminology that we are responsible for selling the product and some improvement in the payment terms. Obviously we can't afford to lose \$3.9M [sic] in revenue.

34. On or about September 20, 2001, defendant SPENCE sent an email to Co-Conspirator A and defendant GAGALIS in which she instructed Co-Conspirator A to alter the original Letter of Agreement so that Enterasys would no longer "be held responsible for the movement of the entire order," to change the payment terms to 75 days and to "[m]ake certain the date on the letter coincides with the [August 31 purchase] order."

35. On or about September 20, 2001, Co-Conspirator A responded to defendant SPENCE's directive by email to defendant SPENCE and APAC's Senior Director of Financial Operations [hereinafter referred to as "Co-Conspirator B"], and stated that "I understand and [Co-Conspirator B] has requested this change from the customer." Also, Co-Conspirator A directed Co-Conspirator B to include defendant SPENCE on all emails, because "[s]he is trying to make sure that everything gets done and needs to be involved in the issues that you and Bruce are going through."

36. On or about September 20, 2001, Co-Conspirator A responded to an email from

another Enterasys employee concerning Ariel which stated, in part, “We need to have them take a hard ownership and responsibility of the product or it won’t be treated as revenue.” In Co-Conspirator A’s response, which he sent to defendants KAY and SPENCE, Co-Conspirator D and others, he acknowledged: “We are aware of the issue and [Co-Conspirator B] is clearing this with the customer.”

37. On or about September 20, 2001, Co-Conspirator B sent an email to Co-Conspirator A and an Enterasys salesman dealing with Ariel, stating that “we will cover this ... order by a side letter instead of putting in the main agreement.”

38. On or about September 20, 2001, Co-Conspirator B sent an email to Ariel stating that the provision making Enterasys primarily responsible for selling the products would be put in a separate side letter.

39. On or about September 20, 2001, defendant SPENCE sent an email to Co-Conspirator B asking whether the Letter of Agreement had been changed yet, stating that defendant GAGALIS was still looking for such information, and stating, “Need it today or it comes off the books.”

40. On or about September 20, 2001, Co-Conspirator B sent an email with proposed revised language for the Letter of Agreement to defendants GAGALIS, KAY and SPENCE, Co-Conspirator A and others for their review.

41. On or about September 20, 2001, Co-Conspirator A and others caused the first page of the original Letter of Agreement to be altered in accordance with defendant SPENCE’s instructions. Specifically, they changed and excised the portions of the agreement relating to: (i) Enterasys’ primary obligation to resell the product purportedly sold to Ariel; and

(ii) the 150 day extended payment terms.

42. On or about September 20, 2001, pursuant to defendant SPENCE's instructions, Co-Conspirator A and others also caused the altered Letter of Agreement to be backdated to coincide with the date on Ariel's August 31 purchase order. Among other things, a facsimile header dated August 31 was affixed to the first page of the altered Letter of Agreement.

43. On or about September 20, 2001, Co-Conspirator A, after receiving an email outlining the terms to be included in a side letter to Ariel, sent an email directing Co-Conspirator B to call the Ariel representative or the APAC salesman and "tell them what we need" regarding payment terms "not covered in the main agreement."

44. On or about September 20, 2001, Co-Conspirator A, Co-Conspirator B and others caused a secret side letter to be issued to Ariel which reinstated: (i) Enterasys' primary obligation to sell the product purportedly sold to Ariel; and (ii) the 150 day extended payment terms.

45. On or about September 20, 2001, Co-Conspirator B sent an email to Co-Conspirator A and others with the Ariel side letter attached and a message that read, in part: "I have advised Bruce that we have moved this [sic] 2 troublesome clauses to a side letter."

46. On or about September 20, 2001, Co-Conspirator C, another employee in Enterasys' APAC sales division, sent an email to Ariel, explaining the combined effect of the altered Letter of Agreement and the secret side letter as follows: "What we all agree[d to] remain[s] unchanged, only the way to express it [is] different to get revenue recognition."

47. On or about September 20, 2001, Co-Conspirator A, Co-Conspirator B and others caused Ariel to execute the altered and backdated first page of the Letter of Agreement.

48. On or about September 20, 2001, Co-Conspirator A and Co-Conspirator B and others caused Co-Conspirator A's initials to be affixed to the altered and backdated first page of the Letter Agreement.

49. On or about September 20, 2001, Co-Conspirator B emailed defendants GAGALIS, KAY and SPENCE and Co-Conspirator A the altered and backdated first page of the Letter of Agreement, stating "finally we manage to get [Ariel] to get this cumbersome language off the main agreement."

50. On or about September 20, 2001, defendant KAY forwarded Co-Conspirator B's email, containing the altered and backdated first page of the Letter of Agreement, to Co-Conspirator D.

51. On or about September 20, 2001, Co-Conspirator D changed the attachments to, and altered the body of, the original September 18 email from the APAC employee who had emailed the original, unaltered Letter of Agreement to him, defendant KAY and others. Specifically, Co-Conspirator D changed the text of the email and substituted the altered and backdated version of the first page of the Letter of Agreement for the original, unaltered version as an attachment to the email.

52. On or about September 20, 2001, Co-Conspirator D emailed a copy of the altered and backdated first page of the Letter of Agreement, and the remaining pages of the original Letter of Agreement, to Enterasys' outside auditors in response to the auditors' request for the original Letter of Agreement. He did so by forwarding to the outside auditors the altered version of the September 18 email from the APAC employee.

53. On or about September 20, 2001, Co-Conspirator D altered the "Word" version

of the Letter of Agreement that he had received on September 18 to match the altered and backdated version of the Letter of Agreement and then sent it to defendant KAY and another Enterasys employee with a note that stated, "I am prepared to send [Enterasys' outside auditor] the attached file ... Do you agree that this is the final agreement?"

54. On or about September 21, 2001, Co-Conspirator D sent an email to defendants KAY and SPENCE, Co-Conspirator A and others advising them that he had provided Enterasys' outside auditor with the altered and backdated Letter of Agreement and that "it looks good to us."

55. On or about September 21, 2001, Co-Conspirator A sent an email to Co-Conspirator D, defendants KAY and SPENCE, and others, which stated, in part: "Would you please touch base with Gayle and make sure that she has everything she needs. thanks."

56. In or about September 2001, in connection with Enterasys' outside auditors' quarterly review of Enterasys' financial statements for the quarter that ended September 1, defendants GAGALIS, KAY and SPENCE, Co-Conspirator A, Co-Conspirator D and others withheld, and caused others to withhold, from Enterasys' outside auditors the first page of the original Letter of Agreement.

57. In or about September 2001, in connection with Enterasys' outside auditors' quarterly review of Enterasys' financial statements for the quarter that ended September 1, defendants GAGALIS, KAY and SPENCE, Co-Conspirator A, Co-Conspirator D and others withheld and caused others to withhold from Enterasys' outside auditors the side letter to Ariel.

58. On or about September 24, 2001, defendants GAGALIS, KAY and SPENCE, Co-Conspirator A, Co-Conspirator D and others caused Enterasys' management to falsely represent to Enterasys' outside auditors that, with respect to the quarter ending September 1: (i)

the company had made available to the auditors all relevant records, including side letters; (ii) there had been no instances of fraud by any member of management or by employees who have significant roles in internal control; (iii) there had been no instances of fraud by others at Enterasys that could have a material effect on the company's financial information; (iv) there had been no violations or possible violations of laws or regulations the effects of which should be considered for disclosure in financial information; and (v) revenue recognized had been modified to the extent appropriate when a right of return or other significant future obligation existed.

59. On or about September 26, 2001, defendants GAGALIS, KAY and SPENCE, Co-Conspirator A, Co-Conspirator D and others caused Enterasys to issue a press release announcing that it had generated approximately \$240 million in sales revenue for the quarter ending September 1 and claiming that it was the sixth consecutive quarter in which Enterasys had met or exceeded Wall Street's expectations.

60. On or about October 16, 2001, defendants GAGALIS, KAY and SPENCE, Co-Conspirator A, Co-Conspirator D and others caused Enterasys to file with the SEC a Form 10-Q with financial statements for the quarter ending September 1 which included the Ariel revenue.

All in violation of Title 18, United States Code, Section 371.

COUNT TWO
Securities Fraud: Issuing False Press Release; Aiding and Abetting
15 U.S.C. § 78j(b), 78ff; 17 C.F.R. § 240.10b-5; 18 U.S.C. § 2

61. The allegations of paragraphs 1 through 9, 20 through 24 and 26 through 60 are realleged as if fully set forth here.

62. On or about September 26, 2001, within the District of New Hampshire and elsewhere, the defendants,

ROBERT J. GAGALIS,
BRUCE D. KAY, and
GAYLE SPENCE a/k/a GAYLE S. LUACAW,

and others, did knowingly and willfully, directly and indirectly, by the use of the means and instrumentalities of interstate commerce, the mails, and the facilities of national securities exchanges: (a) employ devices, schemes and artifices to defraud; (b) make untrue statements of material fact, and omit to state facts necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; and (c) engage in acts, practices, and courses of business which operated and would operate as a fraud and deceit upon purchasers of Enterasys securities, to wit, causing Enterasys to issue a false and misleading press release announcing the financial results for its fiscal quarter ending September 1. Specifically, the defendants caused Enterasys to: (i) include in the financial results reported in the press release revenue that was recorded through the deliberate use of improper accounting practices; (ii) claim in the press release that Enterasys had met or exceeded Wall Street's expectations for the sixth consecutive quarter, when Enterasys had not met such expectations.; (iii) omit to state in the press release that the original Letter of Agreement and secret side letter had been deliberately

withheld from the company's outside auditors; and (iv) omit to state in the press release that fraudulent revenue-related entries were made at the direction of management.

All in violation of Title 15, United States Code, Sections 78j(b) and 78ff, Title 17, Code of Federal Regulations, Section 240.10b-5 and Title 18, United States Code, Section 2.

COUNT THREE
Securities Fraud: Filing False SEC Form 10-Q; Aiding and Abetting
15 U.S.C. § 78j(b), 78ff; 17 C.F.R. § 240.10b-5; 18 U.S.C. § 2

63. The allegations of paragraphs 1 through 9, 20 through 24 and 26 through 60 are realleged as if fully set forth here.

64. On or about October 16, 2001, within the District of New Hampshire and elsewhere, the defendants,

ROBERT J. GAGALIS,
BRUCE D. KAY, and
GAYLE SPENCE a/k/a GAYLE S. LUACAW,

and others, did knowingly and willfully, directly and indirectly, by the use of the means and instrumentalities of interstate commerce, the mails, and the facilities of national securities exchanges: (a) employ devices, schemes and artifices to defraud; (b) make untrue statements of material fact, and omit to state facts necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading, in reports and documents required to be filed with the SEC under the Securities Exchange Act of 1934 and rules and regulations promulgated thereunder; and (c) engage in acts, practices, and courses of business which operated and would operate as a fraud and deceit upon purchasers of Enterasys securities, to wit, causing Enterasys to prepare and file with the SEC an SEC Form 10-Q which reported falsely inflated financial results for the quarter ending September 1, 2001. Specifically, the defendants caused Enterasys to: (i) include in its filed financial results revenue that was recorded through the deliberate use of improper accounting practices; (ii) omit to state in its filing that the original Letter of Agreement and secret side letter had been deliberately withheld from the

company's outside auditors; and (iii) omit to disclose that fraudulent revenue related entries were made at the direction of management.

All in violation of Title 15, United States Code, Sections 78j(b) and 78ff, Title 17, Code of Federal Regulations, Section 240.10b-5, and Title 18, United States Code, Section 2.

COUNT FOUR
Securities Fraud: False Books and Records; Aiding and Abetting
15 U.S.C. § 78m(b)(2)(A), 78m(b)(5) and 78ff, and 17 C.F.R. § 240.13b2-1; 18 U.S.C. § 2

65. The allegations of paragraphs 1 through 9, 20 through 24 and 26 through 60 are realleged as if fully set forth here.

66. From in or about at least September 2001, to in or about at least February 2002, within the District of New Hampshire and elsewhere, the defendants,

ROBERT J. GAGALIS,
BRUCE D. KAY, and
GAYLE SPENCE a/k/a GAYLE S. LUACAW,

and others, knowingly and willfully, directly and indirectly, falsified and caused to be falsified books, records, and accounts of Enterasys. Specifically, the defendants: (i) altered and backdated and caused others to alter and backdate the original Letter of Agreement with Ariel; and (ii) included and caused others to include in Enterasys' financial results revenue that was recorded through the deliberate use of improper accounting practices.

All in violation of Title 15, United States Code, Sections 78m(b)(2)(A), 78m(b)(5) and 78ff, and Title 17, Code of Federal Regulations, Section 240.13b2-1, and Title 18, United States Code, Section 2.

COUNT FIVE
Securities Fraud: False Statements to Auditors; Aiding and Abetting
15 U.S.C. § 78ff, and 17 C.F.R. § 240.13b2-2; 18 U.S.C. § 2

67. The allegations of paragraphs 1 through 9, 20 through 24 and 26 through 60 are realleged as if fully set forth here.

68. On or about September 20, 2001, within the District of New Hampshire and elsewhere, the defendants,

ROBERT J. GAGALIS,
BRUCE D. KAY, and
GAYLE SPENCE a/k/a GAYLE S. LUACAW,

knowingly and willfully made, and caused to be made, materially false and misleading statements, and omitted to state or caused others to omit to state material facts, necessary to make the statements made not misleading, to Enterasys' outside auditors, in connection with an examination of the financial statements, quarterly review, and the preparation and filing of a document and report required to be filed with the SEC. Specifically, they: (a) stated and caused others to state that the altered Letter of Agreement was executed on or about August 31, 2001, when, in fact, they knew it was not executed until on or about September 20, 2001; (b) concealed and caused others to conceal the secret side letter and its terms; and (c) falsely stated and caused others to falsely state that: (i) the company had made available to its outside auditors all relevant records, including side letters; (ii) there had been no instances of fraud by any member of management and by employees who have significant roles in internal control; (iii) there had been no instances of fraud by others at Enterasys that could have a material effect on the company's financial information; (iv) there had been no violations and no possible violations of laws or regulations the effects of which should be considered for disclosure in financial information; and

(v) revenue recognized had been modified to the extent appropriate when a right of return or other significant future obligation existed.

All in violation of Title 15, United States Code, Sections 78ff, and Title 17, Code of Federal Regulations, Section 240.13b2-2, and Title 18, United States Code, Section 2.

COUNTS SIX THROUGH TEN
Wire Fraud – Ariel Transaction Fraud Scheme: Quarter Ended September 1, 2001
18 U.S.C. §§ 1343, 1346 and 2

69. The allegations of Paragraphs 1 through 9, 20 through 24 and 26 through 60 are realleged as if fully set forth here.

70. From in or about July 2001, to in or about at least March 2002, in the District of New Hampshire, and elsewhere, the defendants,

ROBERT J. GAGALIS,
BRUCE KAY, and
GAYLE SPENCE a/k/a GAYLE S. LUACAW,

and others, did knowingly and willfully devise and intend to devise a scheme and artifice to defraud, and to deprive Enterasys of its intangible right of honest services, and to obtain money and property from others by means of materially false and fraudulent pretenses, representations and promises.

Scheme and Artifice

71. The allegations in paragraphs 20 through 24 and 26 through 60 are realleged here as a description of the scheme and artifice.

Use of the Wires

72. On or about the dates specified below as to each count, in the District of New Hampshire and elsewhere, the defendants and others, for the purpose of executing the aforesaid scheme and artifice to defraud, and to deprive Enterasys of its intangible right of honest services, and to obtain money and property by means of materially false and fraudulent pretenses, representations and promises, did knowingly transmit, and caused others to transmit, by means of

wire communication in interstate and foreign commerce, certain writings, signs, signals, pictures and sounds, as more particularly described in each count below:

Count	Date	Wire Communication	Between
Six	September 18, 2001	Email of original Letter of Agreement to defendant KAY and Co-Conspirator D	Singapore and New Hampshire
Seven	September 19, 2001	Email in which defendant KAY directs changes to Letter of Agreement	New Hampshire and Singapore
Eight	September 20, 2001	Email in which defendant SPENCE directs changes to Letter of Agreement	New Hampshire and Singapore
Nine	September 20, 2001	Email in which Co-Conspirator A informs defendant SPENCE that changes have been requested	Australia and New Hampshire
Ten	September 20, 2001	Email from Co-Conspirator B to defendants GAGALIS, KAY and SPENCE and Co-Conspirator D with altered and backdated Letter of Agreement	Singapore and New Hampshire

All in violation of Title 18, United States Code, Sections 1343, 1346 and 2.

COUNTS ELEVEN THROUGH FOURTEEN
Wire Fraud – SAP Transaction Fraud Scheme: Quarter Ended December 29, 2001
18 U.S.C. §§ 1343, 1346 and 2

73. The allegations of paragraphs 1 through 8 are realleged as if fully set forth here.

74. From in or around December 2001, to in or around January 2002, in the District of New Hampshire, and elsewhere, the defendant,

GAYLE SPENCE a/k/a GAYLE S. LUACAW,

and others, did knowingly and willfully devise and intend to devise a scheme and artifice to defraud, and to deprive Enterasys of its intangible right of honest services, and to obtain money and property from others by means of materially false and fraudulent pretenses, representations and promises.

Relevant Enterasys Customer

75. SAP America, Inc. (“SAP America”), an affiliate of SAP, Inc. (“SAP”), was in the business of developing, selling and servicing computer hardware and software systems for commercial applications. SAP America was a potential purchaser and user of Enterasys’ computer networking products. Enterasys was also a customer of SAP.

Scheme and Artifice

76. It was part of the scheme that, during the last few weeks of the quarter ended December 29, 2001, defendant SPENCE, at the behest of a very senior officer of Enterasys, participated in the negotiation of a transaction involving the purported sale of approximately \$2 million in Enterasys products to SAP America and SAP.

77. It was further part of the scheme that, on or about December 6, 2001, when asked whether Enterasys could offer SAP America a right of exchange, the very senior officer of Enterasys responded by email, with a copy to defendant SPENCE, as follows: “Yes. Have to be careful what is written on the P.O. though, but they have my word. Gayle, help out here please. It could be another \$2 Million this Q.”

78. It was further part of the scheme that, in or about December 2001, the very senior officer of Enterasys asked defendant SPENCE to draft a secret side letter reflecting an eighteen month right of exchange with SAP.

79. It was further part of the scheme that, in or about December 2001, defendant SPENCE stated to a representative from SAP during a telephone call that SAP’s purchase order should not reference the right of return, because that would create problems for Enterasys in terms of revenue recognition.

80. It was further part of the scheme that, on or about December 19, 2001, defendant SPENCE emailed the SAP negotiators proposed language for a side letter reflecting the eighteen month right of return.

81. It was further part of the scheme that, on or about December 20, 2001, defendant SPENCE emailed the SAP negotiators a draft side letter reflecting the eighteen month right of return

82. It was further part of the scheme that the very senior Enterasys officer and defendant SPENCE executed and transmitted to SAP and caused others to execute and transmit to SAP a secret side letter in which Enterasys granted SAP a right to exchange, for up to eighteen months, the product it was purchasing from Enterasys.

83. It was further part of the scheme that the very senior Enterasys officer and defendant SPENCE and others caused Enterasys to improperly record approximately \$1 million in revenue on its books and records from the SAP transaction during the quarter ended December 29, 2001.

Use of the Wires

84. On or about the dates specified below as to each count, in the District of New Hampshire and elsewhere, defendant SPENCE and others, for the purpose of executing the aforesaid scheme and artifice to defraud, and to deprive Enterasys of its intangible right of honest services, and to obtain money and property by means of materially false and fraudulent pretenses, representations and promises, did knowingly transmit, and cause others to transmit, by means of wire communication in interstate and foreign commerce, certain writings, signs, signals, pictures and sounds, as more particularly described in each count below:

Count	Date	Wire Communication	Between
Eleven	December 20, 2001	Facsimile transmission of secret side letter	New Hampshire and Germany
Twelve	December 2001	Telephone call re: purchase order should not reference right of return	New Hampshire and Germany
Thirteen	December 20, 2001	Email to confirm that purchase order will not reference right of exchange	New Hampshire and Germany
Fourteen	December 21, 2001	SAP America purchase order	Pennsylvania and New Hampshire

All in violation of Title 18, United States Code, Sections 1343, 1346 and 2.

COUNT FIFTEEN
Mail Fraud – SAP Transaction Fraud Scheme: Quarter Ended December 29, 2001
18 U.S.C. §§ 1341, 1346, and 2

85. The allegations of paragraphs 1 through 8 and 76 through 83 are realleged as if set forth fully here.

86. From in or around December 2001, to in or around January 2002, in the District of New Hampshire, and elsewhere, the defendant,

GAYLE SPENCE a/k/a GAYLE S. LUACAW,

and others, did knowingly and willfully devise and intend to devise a scheme and artifice to defraud, and to deprive Enterasys of its intangible right of honest services, and to obtain money and property from others by means of materially false and fraudulent pretenses, representations and promises.

Scheme and Artifice

87. The allegations in paragraphs 76 through 83 of this Indictment are realleged and incorporated by reference herein as a description of the scheme and artifice

Use of the Mail

88. On or about January 9, 2002, in the District of New Hampshire and elsewhere, defendant SPENCE and others, for the purpose of executing the aforesaid scheme and artifice to defraud, and to deprive Enterasys of its intangible right of honest services, and to obtain money and property by means of materially false and fraudulent pretenses, representations and promises, and attempting to do so, placed or caused others to place in a post office and authorized

depository for mail, and did knowingly cause to be delivered, by mail, according to the directions thereon, check #221638 in the amount of \$1,175,840.58 for the SAP America purchase order.

All in violation of Title 18, United States Code, Sections 1341, 1346 and 2.

A TRUE BILL

Dated: May 19, 2004

Foreperson

PETER E. PAPPS
Acting United States Attorney

By : _____
William E. Morse
Assistant United States Attorney
District of New Hampshire

By: _____
Thomas A. Hanusik
Senior Counsel
Fraud Section, U.S. Department of Justice

Michael L. Koenig
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